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C O N F I D E N T I A L SECTION 01 OF 04 BAKU 000812

SIPDIS

DEPT FOR S/EEE RICHARD MORNINGSTAR; DOE FOR JOHN ELKIND,  
LANA EKIMOFF

E.O. 12958: DECL: 10/08/2019

TAGS: [ENRG](#) [EPET](#) [AJ](#) [TU](#) [TX](#) [GG](#)

SUBJECT: AZERBAIJAN: DOE DEP SEC PONEMAN, SOCAR DISCUSS GAS  
PRICING AND TRANSIT CHALLENGES

Classified By: Acting Deputy Chief of Mission Robert Garverick  
Reasons 1.4 B and D.

11. (C) SUMMARY: Department of Energy (DOE) Deputy Secretary Poneman met with the head of the Azerbaijani state oil company SOCAR, Rovnag Abdullayev, on 5 October while in Baku.

Both concurred on the urgency of resolving issues with Turkey related to gas transit and pricing for Southern Corridor gas, lest commercial partners lose interest in the next year. Abdullayev expressed his frustration with what he views as (Turkey) BOTAS's refusal to compromise or negotiate in good faith. SOCAR continues to push Turkey - with limited success - for parity with the gas prices paid to Russia (\$440 USD/thousand cubic meters), and for lower transit fees. Abdullayev decried the low gas price that Turkey pays to Azerbaijan (\$120 USD/tcm) as exploitation, and appeared cautiously optimistic regarding the appointment of new leadership at BOTAS. President Abdullayev indicated that Shah Deniz II might now come on-line with as much as 17 billion cubic meters (bcm) of gas. He explained that Turkmen President Berdymukhammedov had signaled negotiations on disputed oil fields could continue, an apparent reversal from 10 days prior when he insisted on arbitration. SOCAR has offered significant concessions to Turkmenistan on revenue sharing for the disputed Serder/Kyapaz fields, with a proposed 80/20 split in Turkmenistan's favor. Finally, Azerbaijan and Kazakhstan have agreed to a feasibility study of the Kazakhstan-Azerbaijan Caspian Transportation System (KCTS). END SUMMARY.

DepSec and SOCAR Head Laud  
Positive US-Azerbaijani Relations  
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12. (SBU) Charge D'Affaires Lu, DOE PDAS Elkind, Ambassador (Ret.) Parris, DOE Russian and Eurasian Affairs Deputy Director Burpoe, and staff also participated in the meeting during Deputy Secretary Poneman's October 4 to 6 visit. In a highly formalized but warm meeting, Deputy Secretary Poneman and President Abdullayev lauded the positive state of relations between the US and Azerbaijan, noting the evolution of the energy relationship into a platform for broader cooperation, especially in the area of security. Deputy Secretary Poneman stated that Washington followed with keen interest the negotiations on the Southern Corridor. He indicated that the day-to-day interlocutor in Caspian issues will continue to be Ambassador Morningstar and the State Department's Eurasian Energy office, but that DOE will be strongly supportive in this joint effort.

SOCAR Remains Frustrated with  
Turkish Negotiating Stance  
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¶13. (C) President Abdullayev laid out the difficulties of negotiating with Turkey's BOTAS on gas pricing and transit issues. He explained that Azerbaijan first must negotiate common positions with the 6 Nabucco Consortium members (BOTAS, Bulgarian Energy, MOL, OMV, RWE, and Transgaz) and then use these as starting points for specific negotiations with BOTAS. Abdullayev stressed that BOTAS inevitably rejects the initial position, sending SOCAR back to the consortium to develop a new common position. Abdullayev appears frustrated at this seemingly endless negotiation loop, complaining that SOCAR has made significant compromises, while BOTAS "makes no steps back." He also complained that BOTAS vacillates between wanting to solve the pricing and transit issues as a package, or break them out individually. Abdullayev stated that when SOCAR and BOTAS had been close to solving the "package deal," BOTAS presented a tariff which was not compatible with European rates, as "this is their way of saying no."

Gas Pricing: Azerbaijan Pushes for  
Parity with Russian Pricing  
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¶14. (C) President Abdullayev protested that Turkey was currently buying Azerbaijani Shah Deniz I gas at \$120/tcm, versus \$440 they pay Russia for the same volumes of gas.

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President Abdullayev complained that the "Turks claim to be our brothers, but they won't buy gas from us at European prices." He noted that SOCAR and BOTAS had at one point agreed to a gradual step by step price increase, so that the Turks would be paying market prices for Azerbaijani gas within a few years. However, President Abdullayev, explained, eventually BOTAS rejected the plan.

¶15. (C) President Abdullayev framed the current gas pricing negotiations on the basis of the Russian price, that is, the \$440/tcm that Turkey pays Russia for gas. He stated SOCAR wants to charge "Russian price minus 8%," with BOTAS advocating "Russian price minus 20%." He indicated that SOCAR and BOTAS had most recently compromised on "Russian price minus 12.5%," (Note: presumably about USD \$390.50/tcm. End note.), but then complained the associated transit fees were so high as to make it impossible for SOCAR to agree to this proposal.

SOCAR Fears 3 Year Delay in Shah Deniz II;  
12 Meetings and No Agreement  
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¶16. (C) Abdullayev pointed out that remaining Shah Deniz I pricing issues, Shah Deniz (SD) II pricing, and transit were still being considered in a "package deal." He noted that without agreement on pricing for SD I and II, SOCAR cannot make investments in SDII, which has now created a 2 year delay in developing the large gas field. He fretted that unless a resolution was reached soon, the delay would extend to 3 years.

¶17. (C) Abdullayev complained that while senior Turkish officials had told BOTAS to conclude a deal with Azerbaijan, "they simply don't." President Abdullayev explained that former Chair of BOTAS had told him that the current situation, i.e., an impasse on pricing, satisfies him, because he feared being auctioned or even jailed if he was seen as acting against Turkey's broader interests. If, on the other hand, Azerbaijan were to take Turkey to international arbitration, he could at least say he was protecting Turkey's interests. President Abdullayev fretted that he had 12 meetings with BOTAS, and they had

yet to sign a single document. To add insult to injury, Abdullayev stated that BOTAS then typically complained to the U.S. Ambassador in Turkey that Azerbaijan refused to sell gas to Turkey. He noted that Azerbaijan was of course constrained by the Nabucco partners/investors to accept market prices.

#### New Faces in Turkey Offer Some Hope

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¶8. (C) President Abdullayev noted with some optimism, that in addition to the recent appointment of Turkish Energy Minister Yildiz, Turkey had also appointed a new Chairman of BOTAS in the last week, acting Chairman Konun. Azerbaijani officials are trying to read the tea leaves on the BOTAS appointment, and determine if the appointment will smooth the way in their negotiations.

#### Azerbaijan Hopes for 16-17 BCM from Shah Deniz II First Gas

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¶9. (C) Outlining apportionment of Azerbaijani gas from the Shah Deniz II field, President Abdullayev laid out a few scenarios for the 15 billion cubic meters (bcm) initially envisioned:

--7 bcm to be transited through Nabucco to Europe, with 4 bcm taken off in Turkey, and 4 remaining in Azerbaijan and Georgia for domestic use.

However, President Abdullayev noted that SOCAR was hopeful about new data indicating SD II might generate greater gas volumes than originally anticipated, about 16-17 bcm. Apportionment could then be:

--8 bcm to Europe, 8 bcm to Turkey (of which 4 to 6 would be sold by BOTAS, and the remainder sold by SOCAR and its

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partners in Turkey), and 1 for domestic use.

-- Alternately, 7 bcm to Europe, 6 bcm to BOTAS, 2 for the free market in Turkey, and 1-2 for Azerbaijan and Georgia.

#### Transit Pricing for ITGI

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¶10. (C) On the issue of transit pricing for the Interconnector Turkey Greece Italy (ITGI), President Abdullayev noted that the Turks were now offering \$32, and the two parties had come closer to arriving at a mutually-acceptable figure.

#### Sense of Urgency on Both Sides

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¶11. (C) President Abdullayev and Deputy Secretary Poneman concurred on the urgency of resolving the transit and pricing issues with Turkey. Deputy Secretary Poneman noted that while it was not constructive for the U.S. to take sides between Turkey and Azerbaijan, he stated that, "We understand perfectly your concerns." He expressed concern that failure to resolve the dispute in a reasonable time period, "could be a mortal blow to the concept of a Southern Corridor." Ambassador Parris noted, "I know the Turkish side very well, and it appeared to me that the technical level had inadequate guidance from the political level, this may have been the situation since July, and that may be changing. We will take every opportunity to attach importance to getting these issues resolved."

#### Turkmenistan: One Step Back, One Step Forward

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¶12. (C) President Abdullayev then moved on to discuss Azerbaijan's relationship with Turkmenistan, describing the back and forth regarding the disputed Serder/Kyapaz fields. He said that President Berdymuhammedov had reiterated threats of seeking arbitration as recently as 10 days ago. On October 2, he reversed himself, and signaled that negotiations could in fact continue. President Abdullayev was at pains to point out SOCAR had offered significant compromises on revenue sharing for the Serder/Kyapaz gas field, offering to allow Turkmenistan to keep up to 80% of the revenues, instead of the equal revenue division originally proposed. President Abdullayev also noted that President Berdymuhammedov had originally agreed to consider Azerbaijan's latest Caspian delimitation proposal, but had now changed his mind - under pressure from Russia, Abdullayev suspects. Abdullayev also expressed support for prospects for a trans-Caspian pipeline from Turkmenistan to Baku, noting that such a project presented no environmental threat.

KACTS - Feasibility Study to Move Forward;  
SOCAR Willing to Participate in TCP  
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¶13. (C) Deputy Secretary Poneman queried the status of the proposed Kazakhstan Caspian Transit System (also called the Kazakhstan Azerbaijan Caspian Transit System, KACTS, by Azerbaijani officials), noting industry concern that the international oil companies might be excluded from the business model. He pointed to the obvious success of Baku's partnership arrangements with the IOCs, in which the majors have an equity stake, and highlighted the incentive this provides for joint success in the energy industry. President Abdullayev took this point on board, but did not reply directly. He noted that the Kazak President Nazarbayev had visited Baku on October 2, and that the two nations had signed an agreement to carry out a feasibility study on the KACTS project.

¶14. (C) Abdullayev additionally pointed to interest in constructing a pipeline through Azerbaijan to the Black Sea, and noted the Baku-Supsa pipeline could also be expanded, saying "we have no obstacles to using existing infrastructure." Abdullayev expressed SOCAR's willingness to participate in a trans-Caspian pipeline, directly stating that "if there is sufficient political will, SOCAR has the

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resources to build a trans-Caspian pipeline." Finally concluding the meeting, Adullayev wrapped up, "we have a transparent open position, and we are ready to negotiate with any party."

Comment  
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¶15. (SBU) Despite the numerous obstacles to the conclusion of the Southern Corridor discussed in the meeting, SOCAR President Abdullayev appeared very pleased with the visit to Baku by Deputy Secretary Poneman relatively early in the new administration. Poneman likewise noted with enthusiasm the detail and texture that President Abdullayev's presentation provided on the myriad energy relationships at play in the region. While the path ahead on the substantive issues remains daunting, the strategy of multiple visits by both DOE and the State Department's Office of Eurasian Energy clearly appears to be fostering a positive relationship and information exchange with SOCAR.

¶16. This cable was not reviewed or cleared by Deputy Secretary Poneman or Department of Energy staff.  
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